State bank of India

A value opportunity

Banks & Finance	Sharekhan code: SBIN	Company Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	=	↑	+
RQ	+	↔	+
RV	+	↔	+

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 444**	
Price Target: **Rs. 534**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

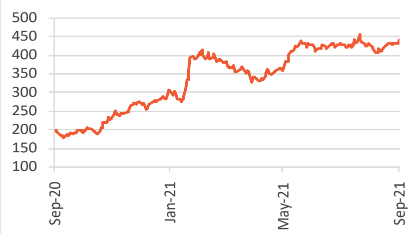
Company details

Market cap:	Rs. 396,119 cr
52-week high/low:	Rs.467 / 176
NSE volume: (No of shares)	96.0 lakh
BSE code:	500112
NSE code:	SBIN
Free float: (No of shares)	378.22 cr

Shareholding (%)

Promoters	57.6
FII	10.3
DII	23.1
Others	9.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.5	3.4	29.7	121.8
Relative to Sensex	-3.4	-9.0	11.6	68.8

Sharekhan Research, Bloomberg

Summary

- State Bank of India (SBI) has pleasantly surprised by keeping asset quality under control during the Q1FY22. Slippages (2.6-2.7% annualised) were higher sequentially, but in line with expectations and better than many private sector banks. In addition, the bank indicated strong recovery in July/August.
- SBI has a healthy provision cover of 86% (including AUCA) as of Q1FY22. The capital adequacy ratio at 13.66% (Tier-I capital at 11.3%) is comfortable and with the government's majority holding, capital and liquidity will not be an issue.
- Net interest margin (NIM) at 2.92% and RoA at 0.6%, are at sub-optimal levels. Normalisation of credit cost and pick up in credit growth should boost RoA and RoE going ahead.
- SBI's subsidiaries are performing well. Valuations are attractive too, adjusting for subsidiary valuations of Rs. 156/share. We retain a Buy rating on the stock with revised SOTP-based price target of Rs. 534, valuing the standalone bank at 1.3x FY23 adjusted book value.

- **Asset quality under control:** SBI managed to keep slippages in line with expectations (2.6-2.7% annualised) and better than many private sector peers. More importantly, the bank saw an improvement in collection efficiencies and pullback in slippages in July/August. The bank has recovered Rs. 4,800 crore in July, while Rs. 2,300 crore has been upgraded from the SME portfolio. The management has indicated they plan to recover Rs. 14,000 crore during the remainder of the financial year.
- **Need to focus on improving NIM & ROA:** Despite an encouraging trend on the asset quality front, the bank still operates at sub-optimal levels, both in terms of NIM (2.92%) and RoA (0.6%). It would have to take steps to improve the yield on advances and improve its core profitability.

Our Call

Valuation –Maintain Buy with a revised PT of Rs. 534: SBI currently trades at 1.8x /1.7x / 1.4x its FY2022E / FY2023E/FY2024E ABVPS, which we believe is attractive considering the value of the franchise (along with subsidiaries). We find that SBI is better-placed with respect to asset quality, capitalisation and underwriting strengths, etc. With its business strengths (being India's largest bank), we expect NII and profitability to bounce back in the next 2-3 years, helped by higher margins. We expect RoEs of 13-14% by FY2022E/FY2023E, helped by normalisation of credit cost and better profitability. We believe SBI presents a value opportunity as it benefits from the turning of a benign corporate credit cycle. It is expected to gain market share and see an improvement of ~80 bps in RoAs. In addition, SBI's stronger deposit franchise, downside support from subsidiaries and a low risk of dilution (as compared to PSU bank peers) further support valuations. We have fine-tuned our earnings estimates and target multiple and see SBI's strong performance, a robust balance sheet and market share gains to be key drivers for re-rating of the stock. We maintain Buy on the stock with a revised SOTP-based PT of Rs. 534.

Key Risks

A slower recovery in the economy, higher slippages due to COVID-19 vulnerabilities and slippages from the corporate book (especially from the 'BB and below'-rated portfolio) could affect earnings.

Valuation Rs cr

Particulars	FY21	FY22E	FY23E	FY24
Net interest income	1,10,710	1,26,291	1,33,035	1,44,497
Net profit	20,412	31,620	40,104	49,025
EPS (Rs)	22.87	35.4	44.9	54.9
PE (x)	18.9	12.2	9.6	7.9
Book value (Rs/share)	258.1	293.5	338.4	367.0
ABVPS (Rs/share)	216.8	244.0	290.3	315.2
P/ABV (x)	2.0	1.8	1.5	1.4
RoE (%)	9.3	12.8	14.2	15.0
RoA (%)	0.5	0.7	0.8	0.8

Source: Company; Sharekhan estimates

Key Investment points

Market leader with a dominant position

SBI is a proxy for the Indian economy. It continues to have a dominant position in the Indian banking system. Its share in the overall systemic loan book stood at 19.77% in FY21, while the share in deposits increased to 23.31% in FY20.

SBI share in India's banking

Particulars	FY16	FY17	FY18	FY19	FY20	FY21
Deposit	19%	19%	25%	23%	24%	23.30%
Loan	20%	20%	22%	22%	22%	19.77%

Source: SBI, RBI

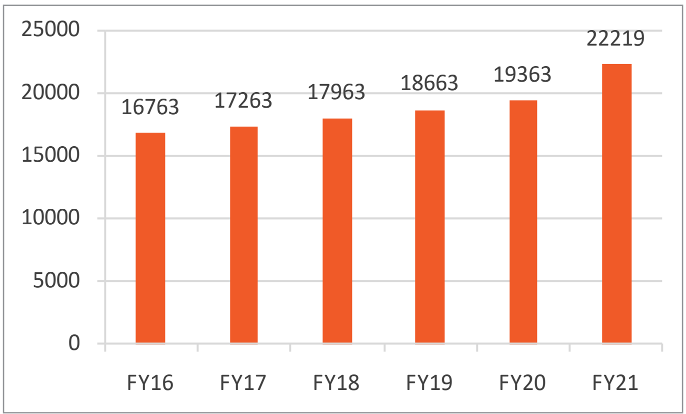
Diversified Loan portfolio

SBI also has a diversified loan book with 39.7% comprising loans to large and mid-corporates, 40% to retail borrowers, 13.7% to SME and 10% to the agriculture segment. About 43% of corporate loans are given to PSUs/ government departments and ~ 76% have a rating of above A-. In the retail segment, 61% are issued for low risk mortgages and > 95% of unsecured personal lending is done to government/PSU employees. Exposure to severely stressed sectors affected by COVID-19 makes up less than 4% of the book (other private sector NBFC/CRE/Aviation/Hotel and Retail/ IPPs rated below A-).

An enviable liability franchise

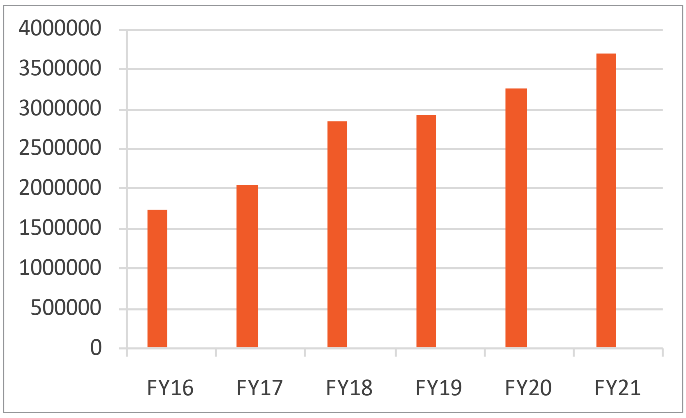
SBI's solid brand image, pan-India presence, and a wide reach in rural and semi-urban areas that resulted in a large and stable deposit base. The number of SBI's branches increased to 22,224 as of June from 16700 in FY16. This has allowed it to maintain a strong deposit base. Liquidity can never be cause of worry for SBI not only because of an excellent liability franchise but also as it can raise capital through stake sales as and when required. It has a high promoter holding in some of its listed subsidiaries so it can sell stakes via OFS and can list its subsidiaries in segments such as general insurance, AMC, etc.

Branches have increased at a feverish pace



Source: Bank, Sharekhan Research

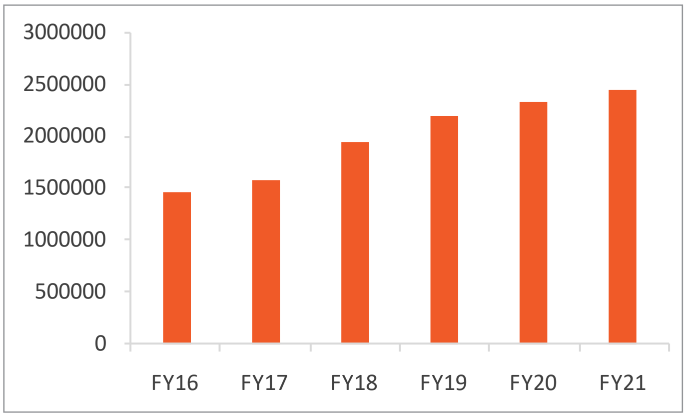
Deposit growth aided by branch expansion



Source: Bank, Sharekhan Research

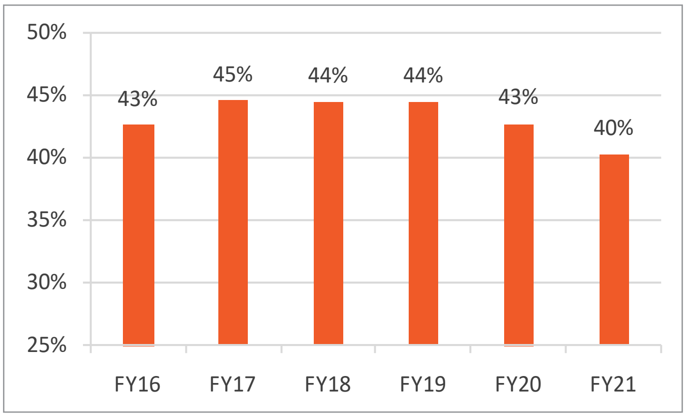
Financials in charts

Loans increased 11% on an average during FY16-FY21



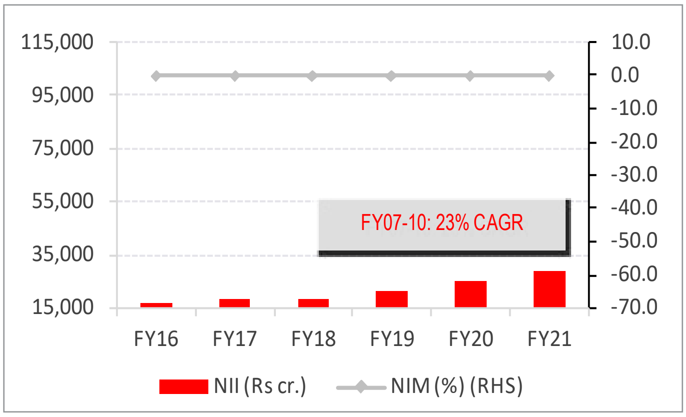
Source: Bank, Sharekhan Research

CASA ratio greater than equal to 40%



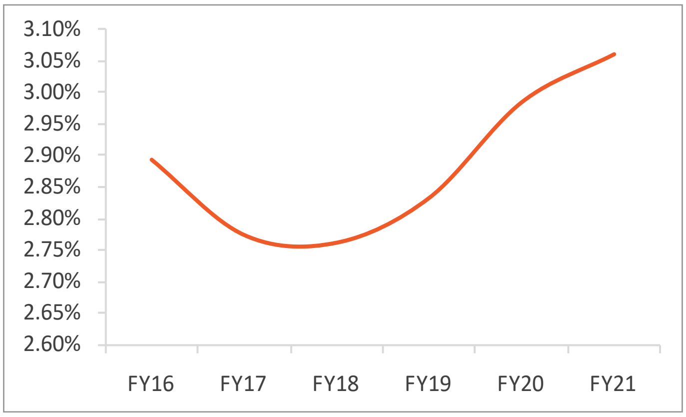
Source: Bank, Sharekhan Research

NII and PAT trends



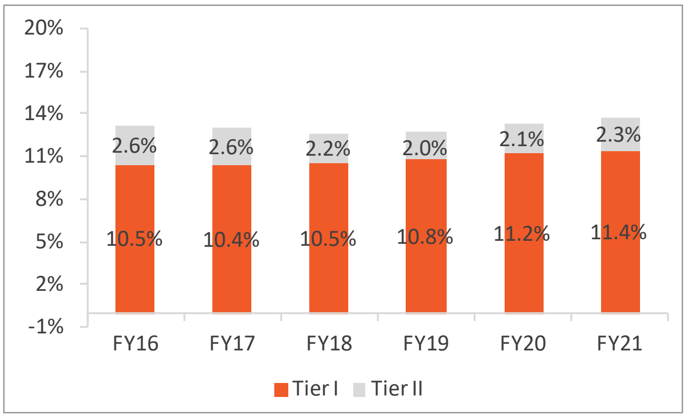
Source: Bank, Sharekhan Research

NIMs has been expanding



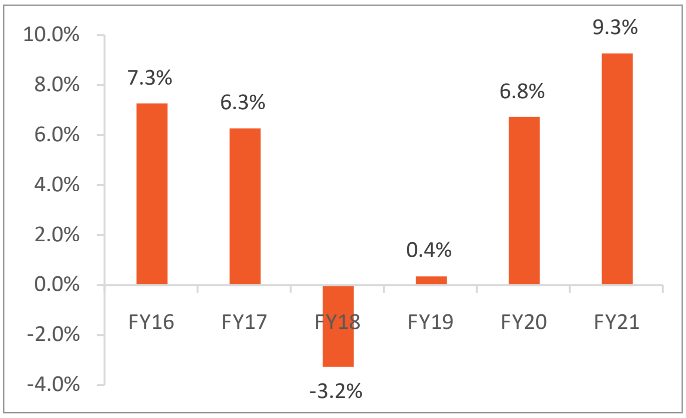
Source: Bank, Sharekhan Research

Well capitalized with CAR at 13.6%



Source: Bank

ROEs has recovered from the lows of -3.2%



Source: Bank

Outlook and Valuation

■ Sector view - Credit growth yet to pick up, stronger banks placed better

System-level credit offtake remains sedate, growing by 6.5% y-o-y in the fortnight ending August 13, 2021. On the other hand, deposits rose by 10.6%, which indicate a healthier economic scenario. Moreover, the RBI's accommodative monetary policy stance, resulting in surplus liquidity, provides succour in terms of easy availability of funds and lower cost of funds for banks and financials. The end of the loan moratorium is a relief. Going forward, corporate exposure is likely to be a function of asset quality, client profile, as well as an economic recovery. At present, we believe that the banking sector is likely to see increased risk-off behaviour, with tactical market share gains for well-placed players. We believe that large banks, with a strong capital base and strong asset quality (with high coverage and provision buffers), are better placed to take-off once the situation normalises.

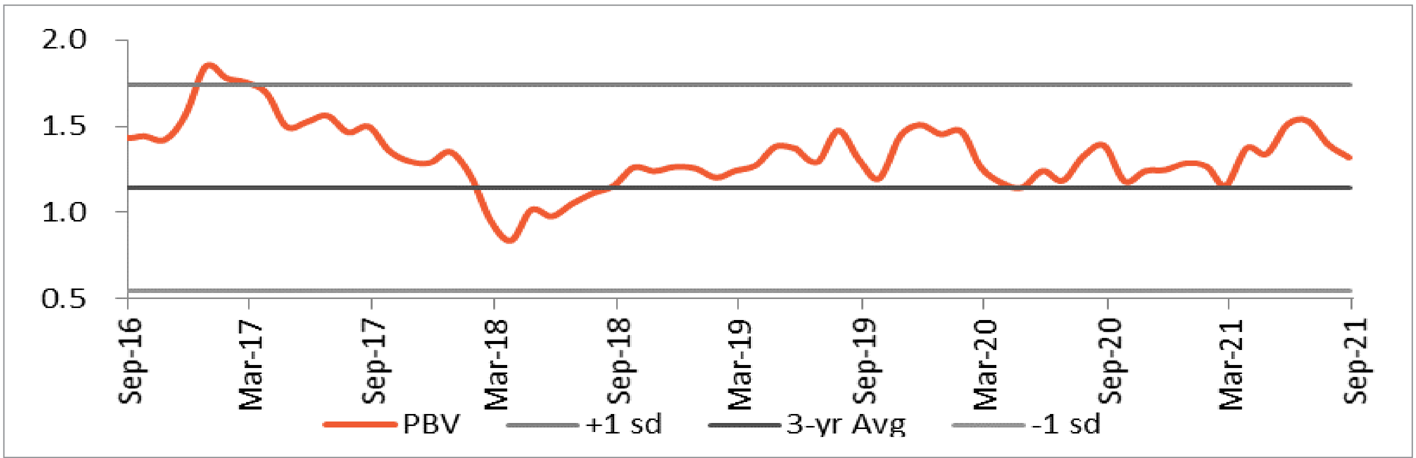
■ Company outlook - Attractive play on gradual economic recovery

SBI is an attractive play on gradual recovery in the Indian economy, with a healthy PCR of 85.9% (with AUCA), robust capitalisation (Tier 1 of ~11.4%), strong liability franchise, and improved core operating profitability. Q1FY22 results indicate that business strength and the last few years' efforts on cleaning up the books have stood the bank in good stead for reducing slippages and supporting margins. Management commentary exuded confidence about NIMs and asset-quality performance going forward; and a healthy provisioning cover on the balance sheet is a comfort factor. The management reiterated that it is well provided for with respect to the legacy book of large stressed exposures and going forward, the impact of residual provisions is likely to be manageable. SBI's status as the market maker in terms of domestic interest rates places it at an advantage to other PSU bank peers, providing a cushion to margins and its strong growth in mortgages and deposits book, which is proof to its market strength. SBI's pole position in terms of liability franchise and an enviable reach and business strength make it well placed to ride over medium-term challenges.

■ Valuation - Maintain Buy with a revised PT of Rs. 534

SBI currently trades at 1.8x /1.7x / 1.4x its FY2022E / FY2023E/FY2024E ABVPS, which we believe is attractive considering the value of the franchise (along with subsidiaries). We find that SBI is better-placed with respect to asset quality, capitalisation and underwriting strengths, etc. With its business strengths (being India's largest bank), we expect NII and profitability to bounce back in the next 2-3 years, helped by higher margins. We expect RoEs of 13-14% by FY2022E/ FY2023E, helped by normalisation of credit cost and better profitability. We believe SBI presents a value opportunity as it benefits from the turning of a benign corporate credit cycle. It is expected to gain market share and see an improvement of ~80 bps in RoAs. In addition, SBI's stronger deposit franchise, downside support from subsidiaries and a low risk of dilution (as compared to PSU bank peers) further support valuations. We have fine-tuned our earnings estimates and target multiple and see SBI's strong performance, a robust balance sheet and market share gains to be key drivers for re-rating of the stock. We maintain Buy on the stock with a revised SOTP-based PT of Rs. 534.

One-year forward PBV (x) band



Source: Company; Sharekhan Research

SOTP Valuation

SBI SOTP	Holding (%)	Valuation Methodology	Value per share
SBI Bank - Parent	100%	1.3x FY2023E ABPVS	377.4
Subsidiaries			
Life Insurance Subsidiary	55.70%	Market Cap post 20% Holdco Discount	60.91
Cards Subsidiary	69.50%	Market Cap post 20% Holdco Discount	65
AMC Subsidiary	63.00%	5% of AUM as on Sep 2021; 20% Holdco discount	20.44
Others			10
		Price Target (PT)	**534**

Source: Sharekhan Research

About company

State Bank of India (SBI) is a largest public sector bank in terms of assets, deposits, branches, number of customers and employees having pan-India presence. The bank has been designated by the RBI as a domestic systemically Important Bank (D-SIB), which means that its continued functioning is critical for the economy. The bank is better capitalized than most PSU banks, it is well placed to gain market share as well as key clients by virtue of lesser competitive pressures.. The bank is well placed to secure growth capital from the government, not only by virtue of being the largest bank, but also with operating parameters that have improved greatly as compared to its peers.

Investment theme

State Bank of India enjoys a dominant position and market share in the Indian banking space, which we expect to be maintained in the near future as well, by virtue of its deep penetration and superior systems. SBI has a strong presence in both retail liabilities as well as retail asset side along with its corporate relationships (due to size, history and market knowledge) which are key differentiators for it. In addition, due to its size, SBI is the market maker for Interest rates, which not only puts it in a dominant position but will also allow it a margin cushion. Going forward, as NCLT / IBC etc work to resolve / recover tangled NPAs, with crucial Govt support leading to faster resolutions, and better loan discipline. We expect a gradual normalization NPA recognition from here. SBI has the largest customer base in the country, by virtue of its largest and pan-India network, which enables it to be the banker of preference across India but also allows it to explore cross sell opportunities.

Key Risks

Rise in slippages and delay in recoveries from stressed corporate loan book and slower growth in retail/MFI loan book may affect earnings.

Additional Data

Key management personnel

Shri Dinesh Kumar Khara	Chairman
Shri Challa Sreenivasulu Setty	Managing Director
Shri Dhananjaya Tambe	Deputy MD/CIO
Shri Swaminathan Janakiraman	MD
Shri Ashwani Bhatia	MD

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.6
2	HDFC Asset Management Co Ltd	2.7
3	SBI Funds Management Pvt Ltd	2.2
4	ICICI Prudential Asset Management	2.05
5	Nippon India	1.3
6	Aditya Birla Sun Life Asset Manage	0.8
7	Kotak Mahindra Asset Management Co	0.8
8	BlackRock Inc	0.7
9	Franklin Resources Inc	0.6
10	FMR LLC	0.6

Source: BSE

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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